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SUBJECT: BRAZIL AND ARGENTINA AGREE ON A TRADE SAFEGUARDS MECHANISM;  
ACCORD ON AUTOS STILL PENDING

¶1. (SBU) Summary. Tensions between Brazil and Argentina over access to each other's markets continue. In early February, Brazil and Argentina finalized their long-running negotiations on a bilateral trade safeguards mechanism should excessive exports from one country endanger an industry in the other. While Brazilian industry (and some within the government) saw the accord as acquiescing to Argentina's one-sided demands, Foreign Minister Amorim - anxious to maintain good relations with the country's neighbors to the south -- defended the agreement as fair and balanced. Meanwhile, contentious talks are still ongoing regarding renewal of the current automotive export agreement between the two countries. The rancorous atmosphere surrounding these two sets of negotiations underscores the difficult nature of the Brazil-Argentina relationship. Many here are beginning to wonder whether Brazil's traditional policy of using Mercosul as a device to manage relations with the Argentines is really worth the trouble. End Summary.

White Smoke on Safeguards

¶2. (SBU) After months of acrimonious talks, Brazil and Argentina finally agreed to a bilateral "competitive adaptation mechanism" (MAC), i.e., a framework for imposing import safeguards. The provisions of this mechanism would be invoked whenever businesses representing 35% of a specific industry filed a request with their government. Thereupon would follow a series of informal industry-to-industry meetings and separate government investigations (possibly lasting up to 340 days), culminating in a potential panel decision should the two sides prove unable to agree. The three panel experts -- one Argentine, one Brazilian, and the third from a non-Mercosul country - would then render judgment, with the complainant country, should it prevail, receiving authorization to impose quotas lasting for 3 years (with a possible 1 year extension). Any exports from the respondent country above the quota would be subject to the Mercosul Common External Tariff for that product, minus ten percent.

¶3. (U) According to the press, the Brazilian export sectors most likely to be negatively affected by the MAC include footwear, textiles, appliances, steel, poultry and pork. Certain Brazilian agricultural producers (wheat, rice, milk, garlic, onions, fruits, and wine) are considering using the MAC offensively against

Argentina.

#### But Still Waiting on An Automotive Industry Accord

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¶4. (SBU) The agreement on the MAC leaves renewal of the automotive industry accord as the principal item remaining on the bilateral trade agenda. Under the "flex" system contained in that document, for every US\$2.60 exported by one country (Brazil), the other (Argentina) must export at least US\$1.00. Brazil wants to leave the formula as it currently stands while Argentina seeks to reduce the flex ratio to 2.20. In addition, Buenos Aires would like the agreement to be of indefinite duration and the flex ratio to be applied individually to every company - instead of the current practice of applying it to the industry as a whole. Both governments had hoped to have the agreement done by the end of November in time for the commemoration of Brazil-Argentina Friendship Day. However, with Brazilian and Argentine automakers each pressuring their government's negotiators, achieving consensus in time, in an atmosphere marked by rancor on both sides, proved impossible. Therefore, the agreement was extended until March, by which time negotiators hope to have an interim agreement in place. A final agreement is not expected until after June.

#### Brazilian Industry Livid

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¶5. (SBU) Brazilian business reps, including spokesmen from the powerful FIESP (Sao Paulo State Industrial Federation) have been vocal in their criticism of the deal the GOB negotiated on the MAC. They question why the GOB agreed to such a lengthy safeguard period (possibly up to 4 years) and point out that under the MAC any space ceded by Brazilian manufacturers in the Argentina market could well be filled by third country producers. Specifically, we have been told that there are studies showing that voluntary limits on

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Brazilian "white goods" exports to Argentina last year resulted in increased imports from third countries, while not a single additional unit was produced in Argentina. In industry's view, government policymakers who already have proven themselves tone-deaf to input on issues such as the FTAA and the proposed EU-Mercosul FTA, once again ignored domestic business interests. Meanwhile, officials at two Sao Paulo-based auto manufacturers have told us that they fear that the GOB will do so again in the ongoing automotive accord talks.

#### Divergent Thinking within the GOB

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¶6. (SBU) In early February, Emboffs spoke with a well-placed MFA diplomat who described the situation within the GOB on this issue. One camp, we were told, recognized that Brazilian business interests were not being served but felt that given Argentina's worries about regaining ground for its industry in the wake of its recent economic meltdown, the importance of maintaining good relations with Buenos Aires trumped all else. The most prominent spokesman for this point of view was Foreign Minister Celso Amorim, who, when the terms of the MAC were announced, publicly characterized it as fair and balanced. The accord on MAC, under this line of thinking, was the price for keeping Mercosul intact. And while one-sided concessions may not make much economic sense, politically they do serve to keep Argentina and Brazil from butting heads and help advance Brazil's aspirations for a U.N. Security Council seat.

¶7. (SBU) A second camp, led by Minister of Development, Industry, and Commerce Luiz Fernando Furlan, saw the MAC as preemptive capitulation. Our MFA interlocutor noted that buried within the text of the agreement was a clause which allowed a party to impose "provisional" safeguards unilaterally should the situation so warrant. Incredible as it sounds, our contact said, the Argentines think the safeguards mechanism will induce foreign investors to invest in Argentina rather than Brazil. Because of his pro-Brazil stance, we were told, Furlan was a hated man in Argentina - so much so that he had not traveled there once during his three years as Minister.

Comment

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18. (SBU) While Amorim prevailed with respect to the MAC and could well impose his imprint on any automotive sector accord, he might not be able to continue his string of wins indefinitely. We heard that had not Brazilian exporters been constrained by Mercosul in negotiating agreements to expand existing (and open new) markets, instead of exporting US\$117 billion in 2005 (a record), they could have done much, much more. Argentina was cited as the culprit in preventing Brazil from concluding an FTA with key trade partners like the U.S. and the EU. Clearly, these statements reflect the dissatisfaction with Mercosul felt by a number of key Brazilian government and industry actors. The entry of Venezuela into the bloc and the growing restiveness of the smaller members - Uruguay and Paraguay, both of which questioned why they were excluded from the MAC talks - will only feed further rethinking regarding the economic benefits of Mercosul.

19. (SBU) Recently Amorim told a visiting U.S. delegation that Venezuela's entry into Mercosul was more "an expression of political hope than an economic reality." Given the Amorim-led effort to pacify Argentina, it is becoming increasingly the case that for Brazil Mercosul is a "political hope, not an economic reality."

LINEHAN